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National Association of State Utility Consumer Advocates
1133 15th Street, N.W., Suite 550 Washington, D.C. 20005
Phone (202) 727-3908 Fax (202) 727-3911 E-Mail nasuca@nasuca.org

June 26, 1996

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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF SECRETARY

Honorable Reed E. Hundt, Chairman
Federal Communications Commission
1919 M Street, N.W., Room 814
Washington, D.C. 20554

Dear Chairman Hundt:

The attached reply comments of the National Association of State Utility Consumer Advocates (NASUCA) are being submitted as an ex parte communication. As official representatives of consumers in state telecommunications proceedings, NASUCA is in a unique position to comment on the important issues being considered by the Board.

Two copies of this letter and attachments are being delivered to the Commission's Secretary for filing in the proceeding.

Very truly yours,

Robert F. Manifold
Assistant Attorney General
Public Counsel
State of Washington

No. of Copies rec'd 0+14
List A B C D E

BEFORE THE
FEDERAL COMMUNICATIONS COMMISSION
WASHINGTON, D.C.

In the Matter Of:	:	
	:	
Federal-State Joint Board on Universal Service	:	CC Docket No. 96-45
	:	

EX PARTE REPLY COMMENTS OF THE NATIONAL ASSOCIATION OF STATE UTILITY CONSUMER ADVOCATES (NASUCA)

NATIONAL ASSOCIATION OF STATE
UTILITY CONSUMER ADVOCATES
1133 15th Street, N.W. Suite 575
Washington D.C. 20005
(202) 727-3908

DATED: June 26, 1996

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EX PARTE REPLY COMMENTS OF THE
NATIONAL ASSOCIATION OF STATE
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(NASUCA)

INTRODUCTION

The National Association of State Utility Consumer Advocates (hereinafter referred to as NASUCA) files these comments concerning the Notice of Proposed Rulemaking And Order Establishing Joint Board (hereinafter referred to as Notice), released on March 8, 1996 as CC Docket No. 96-45. Through this Notice, the FCC sought comment regarding the goals and principles of Universal Service support mechanisms and the activities of the Joint Board in implementing Universal Service support mechanisms consistent with the Telecommunications Act of 1996.

NASUCA is an national association of 41 offices in 38 states and the District of Columbia authorized by state law to represent utility consumers in matters before state and federal regulatory bodies. NASUCA members have been active participants at the state and federal level in the creation of various policies relating to Universal Service.

Although the reply comments of NASUCA are being filed beyond the established date for replies in this docket, NASUCA submits that its unique position as the consumer advocate for utility consumers in 38 states makes the comments of this organization extremely relevant to a proceeding that

concerns the availability of universal telephone service to the citizens. NASUCA therefore requests that the Commission and the Joint Board accept these comments as an ex-parte communication.

Attached to these reply comments is a copy of an April 11, 1996 decision by the Washington Utilities and Transportation Commission regarding a request by US West to increase its rates by $205 million a year and drastically "rebalance" rates. The Washington Commission rejected US West's request for increased revenues by ordering a $91 million revenue reduction and completely rejected US West's request for rate "rebalancing".

We ask that the Commission and the Joint Board take official notice of this landmark decision because of its significant relevance to the current positions that many local exchange carriers are taking in CC Docket 96-45. NASUCA urges the FCC and the Joint Board to recognize that when detailed discovery and full evidentiary hearings on costs and cost studies are conducted, and appropriate economic and regulatory principles are applied, there is no need to "rebalance" rates. "Rebalancing" is simply a euphemistic label for a misguided corporate strategy to secure monopoly profits by unfairly shifting costs away from customers who will have choices under competition, onto customers who will not have choices.

This Commission and the Joint Board must fully appreciate the potential adverse impact on universal service that will occur if the Commission adopts the positions advocated by the local exchange companies who have responded in this docket. In its original comments, NASUCA warned that the LECs would be seeking billions of dollars in support based on faulty and self-serving economic analysis. (We were correct. BellSouth alone says it needs almost two billion dollars.) We reiterate our position that the Commission must carefully scrutinize the claims of the LECs and ultimately reject them, in the same manner as the Washington Commission did in regard to US WEST.

I. THE COMMISSION SHOULD REJECT PROPOSALS TO USE THE UNIVERSAL SERVICE INVESTIGATION AS A VEHICLE TO RAISE RATES -- EITHER DIRECTLY OR INDIRECTLY

The intent of the Telecommunications Act of 1996 was to ensure that a transition to competition takes place in a manner that promotes universal service and protects customers of basic service from unreasonable and discriminatory rate increases. Contrary to this intent, some parties are attempting to use this proceeding as an opportunity to convince the Commission to permit large rate increases, protect telephone companies from bearing the responsibility for their business decisions in a competitive environment, and allow interexchange carriers to avoid paying legitimate costs of service, while, as the same time, improperly shifting those costs to captive customers. If the Commission follows the recommendations of parties who urge rate "rebalancing," it will ensure that few, if any, telephone customers benefit from the introduction of competition. To the contrary, the Commission will have succeeded only in making telephone service less affordable and hindering the development of effective competition.

Specifically, the comments of BellSouth (p. 8), GTE (p. 14), SWBT (p. 2-3), and AT&T (p. 2) contain the incorrect assertion that carrier access charges and toll provide an "implicit support mechanism" for universal service. They argue that the Act requires explicit support for universal service and, therefore, costs currently recovered through access and toll should be shifted to end users through increases to the End User Common Line (EUCL) charge. SWBT asserts the need for both increases to the EUCL and to basic service rates. (SWBT p. 1-3). GTE further argues that adjustments to the EUCL should be made on a geographically deaveraged basis. (GTE , p 15). AT&T proposes that prices for access be set at TSLRIC and that the Commission should establish a universal service fund based on a surcharge on all retail services. (AT&T, p. 7). BellSouth states that it requires almost $2 billion in universal service support, of which the "interstate contribution is $1.036 billion." (BellSouth, p. 7). SWBT argues that the Commission should authorize recovery of its depreciation reserve, totaling over $2.5 billion, through a universal service fund. (SWBT p. 23). SWBT (p. 10-11), and BellSouth

(attachment, p. 33) argue that the Commission should establish "affordability benchmarks" that would permit carriers to shift costs to basic local service customers. For the reasons discussed below, all of these and similar proposals should be rejected.

A. It is Manifestly Incorrect to Contend that Basic Local Service is Receiving an "Implicit Subsidy," and that "Rate Rebalancing" is therefore Justified.

The assertion that carrier access charges and toll rates implicitly subsidize universal service is based on the arbitrary, unreasonable, and unproven assumption that the entire cost of the local loop should be treated as a direct cost of basic local service, and basic local service alone. Virtually every service offered to residential and small business customers relies on the local loop, uses the local loop, and could not be offered without the local loop. The loop is a joint and common cost which should be shared among the many services that must be provided over the loop. As a joint and common cost (sometimes referred to as a "shared cost"), the cost of the local loop should not and cannot be legitimately be treated as a direct cost of local service.

Economists generally agree that if a service is covering its direct costs and is making a contribution to joint and common costs, it is not being subsidized. Even economists representing local exchange companies and interexchange carriers generally agree that the direct costs of a service may be measured as the long run incremental cost, defined as:

> the forward-looking cost avoided (or added) by discontinuing (or offering) an entire service or group of services holding constant the production of all other services produced by the firm.

It is indisputable that 100% of the cost of the loop could not be avoided by discontinuing basic local service, holding constant the production of all other services produced by the local exchange company which necessarily use that loop, unless the production of all other services was held constant by replacing the loop with a more efficient technology for which the cost was zero. If there is no more efficient technology currently available that would enable the local exchange company to hold constant the

production of all other services, then no part of the cost of the loop could be avoided by discontinuing basic local service. If there is a more efficient technology currently available that would enable the local exchange company to hold constant the production of all other services, then the local exchange company could avoid a cost equal to the cost of the loop minus the cost that would be incurred for the more efficient replacement technology. The portion of the cost of the loop that could be avoided by discontinuing basic local service is far less than 100% of the cost, and none of that cost could be avoided in the absence of a more efficient replacement technology. Since the loop is not a direct or incremental cost of basic local service, it must be recognized that it is attributable to all services which necessarily use it.

The direct costs of basic local service include the costs of usage, and other elements of basic service such as billing, directory assistance (in states with free directory assistance allowances), a telephone listing, a directory and 911. While the above-referenced comments do not provide sufficient information for the Joint Board to examine in detail the reported costs of providing local service, it is clear that the loop is the single most expensive component of the alleged cost of local service. When the loop is correctly treated as a joint and common cost, it becomes apparent that basic local service is covering its direct costs and is not receiving an "implicit subsidy."

Such a finding has recently been made in Iowa. In its first decision concerning the resale of unbundled loops, the Iowa Utilities Board found there was no need to establish an interim universal service charge because "... on the basis of this record ... no significant subsidy is flowing to residential customers in Iowa. ..." In Re U S WEST Communications, Inc., Docket No. RPU-95-10, Final Decision and Order, May 17, 1996, p. 26.

It is sometimes argued that the fact that companies are now offering an "unbundled" loop to competitors demonstrates that the common line costs should no longer be allocated among all services that require the common line, but should be fully recovered from end users. This is an incorrect argument. If a LEC rents an unbundled loop to a competitive local, the competitive carrier will offer a number of

services over that loop, including local, toll, switched access, custom calling, etc. Therefore, the loops will still be shared by a group of services, and no one service should cover the full cost of the unbundled loop. It is therefore reasonable for a competitive carrier to pay an unbundled loop rate which in total covers the full cost of the unbundled loop, because the competitive carrier obtains exclusive control of that facility. However, basic exchange service is not the only service that shares the common line and, consistent with the Act, the rate for basic exchange service should not cover the full cost of the line.

B. The Commission and Many States Have Found that the Loop is a Joint and Common Cost

Both the Commission and numerous state commissions have found the local loop to be a joint and common cost, and its recovery from all services using the loop to be fully appropriate. The Commission itself has long recognized the "joint and common" nature of the loop. Generally, the Commission has referenced the local loop as the "common line" through which all carriers are able to provide services to end users. In a recent case concerning a NYNEX Telephone Companies Petition for Waiver (10 FCC Rcd. 7445, May 4, 1995), the Commission discussed the competitive conditions that NYNEX faced in the New York City area. In that discussion, the FCC referenced the joint and common nature of the local loop:

> In addition, we note that the NYPSC has permitted competition in the provision of all intrastate telecommunications services, including local exchange service, as well as switched access, special access, interLATA and intraLATA toll, and private line. That Commission has certified new competitive entrants as "LECs," and has given them rights comparable to those of incumbent LECs such as NYNEX. While our jurisdiction extends only to interstate telecommunications services, the joint and common character of the facilities providing exchange access and local exchange service means that the regulatory climate for interstate telecommunications services affects the development of competition in the interstate access market.

Id. at ¶ 39. (emphasis added) The Commission correctly considers the cost of the local loop a "joint and common" cost.

How joint and common costs, particularly local loop costs, should be recovered has been considered by the courts and state commissions for many years. In the leading case of Smith v. Illinois

Bell Telephone Company, 282 U.S. 133 (1930), the Illinois Commerce Commission had ordered AT&T to reduce some of its rates. (282 U.S. at 142) The federal district court enjoined the Commission from enforcing its order. However, the Supreme Court set aside the district court order because neither the Illinois commission nor the court had separated the interstate and intrastate rate base. (Id. at 148)

The federal district court, in overturning the Illinois commission order, did not attempt to separate the interstate and intrastate rate base. (Id. at 146-147) Instead, all of the loop or "exchange property" was "attributed to intrastate service by the district court." (Id. at 150) The Supreme Court rejected this view, holding as follows:

> The appellants insist that this method [i.e., allocating all of loop costs to exchange service] is erroneous, and they point to the indisputable fact that the subscriber's station, and other facilities of the Illinois Company which are used in connecting with the long distance toll board, are employed in the interstate transmission and reception of messages. While the difficulty in making an exact apportionment of the property is apparent, and extreme nicety is not required, only reasonable measures being essential [citations omitted], it is quite another matter to ignore altogether the actual use to which the property is put. It is obvious that, unless an apportionment is made, the intrastate service to which the exchange property is allocated will bear an undue burden -- to what extent is a matter of controversy.

[Id. at 150-51] Thus, the Supreme Court held that the local loop could not be considered as 100% assignable to local exchange service, but was a shared cost of intrastate and interstate services.

This point has also been recognized by several states. It is important to note that these decisions have been reached based on a careful examination of evidence tested by discovery and cross examination in formal hearings. Absent such a process it would be difficult, if not impossible, to assess the accuracy of reported costs. In the course of considering universal service issues, we urge the Commission to bear in mind the care with which the states have examined and then rejected claims that local service is "subsidized."

Most recently, the Washington Utilities and Transportation Commission (WUTC) found that the local loop is a shared cost that should not be considered a direct cost of local service and should not be recovered solely in local service rates.[1] The Washington Commission stated:

> The Commission finds, consistent with the presentation of Public Counsel/AARP, and other parties that the cost of the local loop is not appropriately included in the incremental cost of local exchange service. The local loop facilities are required for nearly every service provided by the Company to a customer. Neither local service nor in-state long distance service nor interstate long distance nor vertical features can reach a customer without the local loop. Should USWC cease to provide any one of these services, its need for a local loop to provide the remaining services would remain. The cost of the local loop, therefore is not incremental to any one service. It is a shared cost that should be recovered in the rates, but no one service is responsible for that recovery. USWC's presentation that the local loop is appropriately and necessarily an element of the cost of local exchange service, made through the testimony of witness Farrow, is not credible in light of the purposes of a long run incremental cost study and is inconsistent with accepted economic theory regarding such studies.
>
> USWC argues that allocation of any loop costs to access and toll service violates the principle of incremental costing, because the entire loop cost would exist even if no carrier access or toll services were provided. This argument addresses why loop costs should not be included in the incremental cost of toll and access, but it does not explain why they belong in the incremental cost of local service. The argument applies equally well in application of the costs to local exchange service.

US WEST Order at 83-84 (emphasis added). Consistent with this discussion, the Washington Commission then determined that local exchange service was not cross-subsidized and explained its conclusion as follows:

> The most important question to be answered by cost studies in this case is whether residential local exchange service is being cross-subsidized by business and toll service. USWC argues that this cross-subsidy exists and is undermining its ability to remain competitive. Other parties, including Staff, Public Counsel, TRACER, MCI and AT&T argue that the residential local service rate covers its incremental cost.
>
> The evidence clearly shows that residential service is covering its cost. The incremental cost of local service is approximately $4.42. This amount is calculated by subtracting the Hatfield model results for loop costs ($8.96 [Ex. 765-T, 4]) from the Hatfield model results for the total cost of local service ($13.38 [Ex. 767]), using the modified fill factors. These values are only approximate, in part because any model result is only approximate

[1] Washington Utilities and Transportation Commission v. US WEST Communications, Docket No. UT-950200, Fifteenth Supplemental Order, Commission Decision and Order Rejecting Tariff Revisions; Requiring Refiling (April 11, 1996).

and in part because the Hatfield model results do not necessarily reflect the input value determined earlier to be appropriate.

> The conclusion to be drawn from these cost results is that residential service does not receive a subsidy at current rates. The average residential customer today pays $10.50 for local service and EAS adders, plus a subscriber line charge of $3.50. If USWC were to exit the local residential exchange market, its revenues would decrease by $14.00 per customer, and its costs would decrease by about $4.42 per customer. Not only does residential service cover its incremental cost (the test for cross-subsidy), it even covers the incremental cost of the local loop that is used to provide local, long-distance, and vertical services, since the revenue from local service, including the subscriber line charge, exceeds the $13.38 cost of local service plus the local loop.

US WEST Order at 89-90 (emphasis added).[2]

The Washington ruling is important because it was decided in a state where local competition has been permitted. We fully expect LECs to argue that the advent of local competition has somehow altered the economic character of the loop to such an extent that it has been somehow transformed from a joint and common cost into a cost that has to be recovered from captive customers in the interests of "economic efficiency."[3] The Washington Commission carefully examined the issue of the costs of the loop, fully aware of the changing telecommunications environment, and correctly found that loop costs are shared costs.

The Pennsylvania PUC concluded that loop costs are joint and common costs, explaining its findings as follows:

> We agree with PTA and OCA [Office of Consumer Advocate] that local loop costs are joint or shared costs since the local loop is jointly utilized to provide a wide array of

---

[2] The Maine Public Utilities Commission (MPUC) also found that basic local exchange service more than covers its costs. the MPUC refused to allow NYNEX (then New England Telephone or NET) to increase basic rates by 25% and decrease toll rates by 10% (which would have resulted in revenue neutrality) in part because:

> The Company's cost study concluded that, even if 100% of loop costs are assigned to basic service (as done in the NET study), current local exchange revenues exceed the long-run marginal cost of exchange service. Thus based on the evidence presented in this case, we cannot conclude that basic exchange service is being subsidized by other services.

MPUC Order, Docket No. 92-130, April 13, 1994, p. 38-39. Moreover, the competing stand-alone cost studies presented by Commission staff in Maine concluded that local exchange service in Maine was actually subsidizing other services. Id. at 38.

[3] See, for example, p. 4 of the attachment to BellSouth's opening comments.

> telecommunications services, among which are basic universal services. Our view is unaffected by whether one views basic universal service as a single service or a group of services. Regardless, we believe an appropriate portion of local loop costs should be assigned to basic universal service, consistent with the treatment of other joint, shared or common costs.

Formal Investigation to Examine and Establish Updated Universal Service Principles and Policies for Telecommunications Services in the Commonwealth, Docket No. L-00940035, Order of September 5, 1995 at 12 (emphasis added).

In Pennsylvania PUC v. Breezewood Telephone Company, 74 Pa. PUC 431 (1991), the Pennsylvania PUC also considered this issue in the context of AT&T's contention that the Carrier Common Line Charge ("CCLC") did not represent a cost which BTC incurred to provide access, and that these dial tone line costs could be largely recovered through BTC's local exchange and toll rates, but not through its access charges. Id. at 489-90. The state consumer advocate in the Breezewood case explained this point, arguing as follows:

> ... NTS access line costs are joint costs of providing local, toll, access, and other services (OCA St. 1, p. 41). Dr. Johnson argued that IXCs such as AT&T must make use of the local loops that give rise to NTS costs in providing toll service to local customers, and that it is proper for the IXCs to contribute to these joint NTS costs through the CCLC. (*Id.* at 42)

Id. at 490. In its decision, the PUC agreed:

> We want to state that we consider the costs associated with the loop from the central office to the customers premises a non-traffic sensitive joint cost. We further state that the reductions in CCLC are steps in the right direction.
>
> AT&T states that the Recommended Decision is not clear on whether NTS costs are joint costs of providing local and toll services. It asserts that our Final Order should declare that dialtone line costs are not "joint costs" of various services, but instead are the costs of establishing the physical connection between each customer's premises and the Company's central office.
>
> There is no dispute that both the local customer and AT&T make use of the same local network to complete both local and interLATA toll calls. If it were not for the existence of the local network, AT&T would be required to construct at considerable expense an alternative means of access to the local customer. We find that the CCLC is the cost of compensating BTC for the use of the common line, and as such, CCLC clearly pays for a service received by AT&T. Thus, dial tone line costs are joint costs.

Id. at 494 (emphasis added).

The Colorado Public Utilities Commission also considers loop costs to be joint and common costs, in a docket where it promulgated regulations governing cost allocation. The Colorado regulations (effective July 30, 1993) state:

> As an example, consider the access loop. The access loop is not a separate service but rather is an input necessary for the provision of many telecommunications services. As such, costs associated with the access loop will not appear in the total service long run incremental cost of any single service requiring the access loop but will appear as part of the total service long run incremental cost of the entire group of services requiring the loop. Consequently, prices must be set so that the sum of the revenues from all services requiring the access loop covers not only the sum of the total service long run incremental costs for the individual services but also the shared cost of the loop. (4 CCR 723-30, Rule 4(2)(a)(iii))

Similarly, the New Hampshire Public Utility Commission has considered local loop costs as joint costs that should be recovered from services that use it:

> The Commission is well aware of the [New England Telephone's] claim that basic local exchange service has been and continues to be subsidized by toll. In the past, the notion of various services contributing to the support of basic exchange has been reinforced by cost studies that have served to demonstrate that the "contribution"paid by customers of other services represents a disproportionately greater share of the company's incurred costs. These studies have served to mislead due to the company's decision to assign [dial tone] costs to local exchange services despite the fact that both interstate and state toll services are provided over local NTS facilities. Without local exchange facilities, there would be no mechanism to connect interexchange services to the majority of customers premises. Since clearly the availability of the local network for toll use is a benefit to interexchange carriers and all toll customers, the commission believes that assignment of [dial tone] costs solely to local exchange services is unreasonable.

New England Telephone Generic Rate Structure Investigation, New Hampshire Public Utilities Commission, DR 89010, slip op. March 11, 1991 at 39-40 (emphasis added).

The Florida Public Service Commission issued a similar ruling:

> Upon consideration, we must reject the proposition that no NTS costs should be recovered from access charges. We agree with Quincy, Sprint, FACT and Public Counsel's arguments on this issue. Further, we believe that the IXCs, through their respective toll customers, benefit from the existence of the local network and that they should make a contribution towards this support.

> As we stated in Order No. 12265, in response to previous attempts to persuade us to accept the "no NTS" position, "The notion that an IXC should pay nothing for the subscriber loop because its use does not impose additional costs on the LEC is ill founded and contrary to common business practice, which is to charge customers for use of fixed cost facilities in the price for goods and services." It is appropriate that each service provide some contribution toward the fixed costs common to those services.

Re: Investigation into Nontraffic-Sensitive cost Recovery, Docket No. 860984-tp, Order No. 18598, Fla. PSC, 89 PUR4th 258, 265-66 (1987).

The Louisiana Public Service Commission made a similar determination, as follows:

> While the argument [that the subscriber causes all loop costs to be incurred merely by subscribing] has superficial appeal, it ignores the fact that every time an *inter* exchange call is completed over the local loop to the end user, the *inter* exchange carrier is receiving the benefit of that plant. The local loop is needed by the interexchange carrier to complete its calls. While it is true that it is impossible to precisely apportion the specific costs which should be born for that plant by the interexchange and local carrier, the fact remains that the interexchange carrier benefits from that plant and should pay for a portion of it.

Ex parte South Central Bell Telephone Company, Docket No. U-15955, Order No. U15955, 83 PUR4th 1, 5 (1987).

Consistent with the foregoing cases is a decision by the Minnesota Public Utilities Commission (MPUC), which found that the non-traffic sensitive (NTS) costs of the local loop are appropriately shared by local and toll services. In its order in the 85-582 proceeding, the MPUC stated:

> The Commission finds that it has repeatedly recognized that NTS costs are joint costs of both local and toll service....

In the Matter of a Summary Investigation Into IntraLATA Toll Access compensation for Local Exchange Carriers Providing Telephone Service Within the State of Minnesota, Docket No. P-999/CI-85-582, Order of November 2, 1987, p. 31. The Commission confirmed this conclusion, further stating:

> As the Commission previously has found, local and toll service jointly use the loop and must share responsibility for its costs.

Id at p. 33.

These cases demonstrate that the loop is a joint and common cost. The Commission, the Supreme Court, and the many states referenced in this discussion have consistently reaffirmed this point.

The contrary, self-serving claims made by the local exchange companies in this docket should not be countenanced.

C. The Act Precludes 100% Recovery of Loop Costs from Basic Exchange Service

The parties supporting rate "rebalancing" through a massive shifting of joint and common loop costs to captive customers assert that this would be consistent with the Telecommunications Act of 1996 ("the Act"). They are wrong. In fact, the Act precludes 100% of loop cost recovery from basic local service. Section 254 (k) states that federal and state regulators shall establish guidelines ". . to ensure that services included in the definition of universal service bear no more than a reasonable share of the joint and common costs of facilities used to provide those services." (emphasis added) In the Commission's NPRM, the discussion of the definition of "universal service" demonstrates that the Commission contemplates basic local exchange service to be a service that is "included in the definition of universal service," and we agree. Consistent with the Commission's position and the holdings of the many state commissions discussed above, the costs of the loop are joint and common costs and thus are subject to the Act's requirement that they may not be solely recovered from local exchange service.

This prohibition on 100% recovery of loop costs from basic local service is reinforced by the Congressional Joint Explanatory Statement of the Committee of Conference ("Committee Report"), which explains the related provisions originally contained in the Senate bill. S. 652 required federal and state guidelines to ensure that universal service should "bear no more than a reasonable share (and may bear less than a reasonable share) of the joint and common costs of the facilities used to provide both competitive and noncompetitive services."[4] In the final draft of the legislation, the Conference Committee explained that the House receded to the Senate with minor modifications concerning the current § 254 (k).[5]

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[4] U.S. House of Representatives, 104th Congress, 2nd Session Report 104-458, Telecommunications Act of 1996, Conference Report, January 31 1996 p. 129.

[5] Id. p. 134.

It is obvious that Congress intended to limit the share of joint and common costs that basic service shall bear, going so far as to prohibit the Commission and the states from requiring that basic service bear more than a reasonable share of joint and common costs. Certainly, this "reasonable share" must be considerably less than 100% or there would be no real purpose served by this requirement of the Act. The Senate's view concerning cost allocation should be given great weight in interpreting this statute.

D. "Rate Rebalancing" is a Euphemism for Anticompetitive Price Discrimination

Some parties advocating "rate rebalancing" through shifting 100% of loop costs to basic local service attempt to justify this on "efficiency" grounds. BellSouth attaches comments prepared by Kenneth Gordon and William E. Taylor of the consulting firm National Economic Research Associates (NERA), who argue that in the interests of "efficiency," prices for inelastic local exchange services should be increased as much as possible. (BellSouth attachment, p. 4) The outcome of such a proposal would be that customers who receive an essential service, for which they have little or no competitive choice, would be forced to pay most or all of the joint and common costs incurred to provide both monopoly and competitive services. This isn't "efficiency;" it is unfair, unjust and unreasonable ratemaking. It is unjust discrimination and it is anti-competitive.

There is nothing novel about these proposals. History is replete with attempts by utilities to maximize profits through arbitrarily allocating the lion's share of joint and common costs onto their most captive customers. The Smith v. Illinois Bell decision, discussed above, arose as a result of attempts by Illinois Bell to maximize profits by shifting all of its joint and common local exchange costs to the intrastate jurisdiction, where it was provided a rate of return on its investment under regulation. Since, at the time, no such regulation existed for telecommunications under federal jurisdiction, Illinois Bell had a strong economic self-interest in allocating all of its joint and common local exchange costs from the

intrastate jurisdiction.[6] As discussed above, the Supreme Court ruled that interstate services must pay some of these costs. Although the parties and the climate may be different, the LECs economic goals remain unchanged.

Reaching a similar conclusion in more recent times, the Colorado Public Utilities Commission accurately assessed the situation in a decision in which it rejected use of a pricing mechanism to allocate 100 % of loop costs to local exchange service, and pointed out the unfairness of such a proposal:

> Although touted as a forward-looking and accurate cost method, the Commission finds that LRIC costing is fraught with a number of difficulties. LRIC costing leaves the indirect (that is, joint and common) costs still to be collected from some source. If competitive products and services are priced at the margin, we agree with Staff that the basic exchange (which is a basically inelastic market) becomes a sump into which all the joint and common costs are thrown. In other words, competitive services (priced at the margin) get the advantage of a free ride in that the joint and common costs attributable to their production are not collected from the consumer of the competitive service or product, but rather from the consumers of those services and products, such as basic exchange, to which all the joint and common costs have been allocated. Since the basic exchange telephone ratepayers have nowhere else to go (that being the definition of an inelastic market), the joint and common costs are dumped on them.

Re Mountain State Telephone and Telegraph Company, I&S Docket No. 1720, Decision No. C87-364, 82 PUR4th 64, 84 (1987).

If all telecommunications markets -- and all customers -- experienced effective competition, the ability to engage in such discriminatory pricing would be largely eliminated, as long as effective competition for all customers could be sustained. However, we are nowhere near that situation. Most residential and small business customers have no choice but to receive basic local service from incumbent LECs. Further, it is plain that facilities-based competition will be slower to emerge in less densely populated areas. The temptation will be great for LECs, as a means of lowering prices for other less captive customers, to attempt to shift as much of the joint and common cost responsibility as possible

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[6] William H. Melody, "Cost Standards for Judging Local Exchange Rates," in Diversification, Deregulation, and Increased Uncertainty in the Public Utility Industries, Proceedings of the Institute of Public Utilities Thirteenth Annual Conference, edited by Harry M. Trebing (East Lansing: Graduate School of Business Administration, Michigan State University, 1980), p. 482.

onto customers with the least chance of experiencing competition. GTE's proposal to deaverage the EUCL is a classic example of this. It is clear that the assertions about "efficiency" are really a pretext for proposals to convince the Commission to permit LECs to maximize profits by improperly recovering all of the joint and common loop costs from captive customers. In addition to harming captive customers, this practice is also anti-competitive. This is precisely the type of abuse that regulation is intended to prevent.

II. THE ACT REQUIRES UNIVERSAL SERVICE TO BE FUNDED BY CARRIERS

Advocates of funding universal service through increasing end user rates and charges propose shifting costs to end users by at least three methods: 1) through increases to basic service rates; 2) by an additional end user charge to support a universal service fund; and 3) by increases to the EUCL. All of these proposals are contrary to the Act, which specifically requires carriers to fund Universal Service.

GTE proposes funding universal service through an end user surcharge. GTE criticizes the proposal for carriers to contribute to a universal service fund on the basis of their net revenues, arguing this would not make the alleged current "subsidy" explicit but would continue to bury it in the rates charged to customers. (GTE p. 17-18.) AT&T proposes that prices for access be set at TSLRIC and that the Commission should establish a universal service fund based on a surcharge on all retail services. (AT&T, p. 7)

The positions advanced by GTE and AT&T (and others) arguing for a universal service fund supported by additional charges to end users are contrary to the Act. Section 254 (d) states:

> Every telecommunications carrier that provides interstate telecommunications services shall contribute, on an equitable and nondiscriminatory basis, to the specific, predictable, and sufficient mechanisms established by the commission to preserve and advance universal service.

Congress was perfectly clear: carriers -- not ratepayers -- are required to contribute to the new universal service mechanisms established by the Commission. If Congress wanted to fund universal

service through end user charges it would have done so. and it has not. Proposals to fund universal service through end user surcharges violate the clear intent and will of Congress. Accordingly, the Commission should categorically reject proposals to fund universal service through end user charges.

The assertion of GTE and AT&T that end user funding is necessary to comply with the Act because it would eliminate "implicit subsidies" is plainly wrong. As discussed in section I of these comments, there is no "implicit subsidy" of basic local service. Requiring toll carriers to pay for a portion of the loop is not a "subsidy" because it is that toll carrier's share of the common line facility costs. Therefore, carrier funding is compatible with the "explicit" test of § 254 (e). Universal service funding can be explicit and placed on carriers. Increasing the FUCL as a means of supporting universal service would the violate the Act's provision that carriers. not end users, fund universal service.

The Commission's Notice clearly views basic exchange service as a service that is included in the definition of universal service, pursuant to §254 (k). (Notice at ¶ 18-22) If the Commission anticipates limiting universal service funding to "high cost" customers, it should be aware that in state universal service proceedings LECs are arguing that most basic exchange service customers are subsidized and the LECs are requesting either large basic service rate increases or large universal service funds. As discussed in section I. C. of these reply comments, §254 (k) precludes recovering more than a reasonable share of joint and common costs from services included in the definition of universal service. Proposals to raise basic service rates by parties in this proceeding, and in those states currently working to establish universal service funding mechanisms, are based on recovering an unreasonable share of joint and common costs from basic service rates and are, therefore, contrary to the Act. The requirement of the Act that telecommunications carriers contribute to universal service is reasonable, since those carriers benefit from universal service. Because of the interdependence of communications, the value of the entire network increases for all. If an interexchange carrier could connect to only 10% , 20% or even 50% of the telephones, their business would be greatly harmed. Universal service benefits everyone, including the carriers. Therefore, it is reasonable for charges on the carriers to help support

universal service. The value of the interexchange carriers' business is based in large part on the fact that they can connect calls to and from a large number of premises. No one is suggesting that the carriers should pay 100% of the common line cost, but requiring them to support a reasonable share of the common line facilities from which they so greatly benefit is reasonable.

NASUCA understands the economic issues associated with universal service funding. The Act treats universal service funding as a cost of business for telecommunications carriers. The costs of doing business, including universal service fund contributions, will ultimately be recovered through rates for services charged to customers. However, as pointed out in our opening comments, consumers are better off under carrier funding than if costs were simply passed directly through via end user charges. (NASUCA comments, p. 16-17) Since all carriers must contribute to universal service funding, all carriers have an incentive to ensure that the funding mechanism operates in an efficient and effective manner. Such efficiency would not be encouraged if carriers were permitted to simply pass charges through to customers. The fact that parties such as AT&T and GTE are strenuously advocating end user charges and opposing carrier funding indicates that these two options would have different consequences for carriers and, by inference, for ratepayers.

III. THE COMMISSION SHOULD REJECT SWBT'S REQUEST THAT IT BE PERMITTED TO RECOVER ITS DEPRECIATION RESERVE FROM A UNIVERSAL SERVICE FUND

SWBT, following in the footsteps of its potential affiliate Pacific Bell, argues that the Commission must grapple with yet another mythical form of "implicit subsidy" -- SWBT's depreciation reserve. SWBT notes that increased competition has triggered the discontinuance of regulated accounting for external financial reporting, pursuant to SFAS 101, causing SWBT to "write-up" a depreciation reserve of approximately $4.7 billion.[7] SWBT proposes to recover the shortfall based on a theoretical reserve

[7] This argument is virtually identical to that put forth by Pacific Bell, a firm proposing to merge with SWBT, before the California Public Utilities Commission (CPUC). Pacific Bell asked the CPUC to grant recovery of $4.7 billion, the intrastate portion of a reported $5.3 billion depreciation reserve. An administrative law judge rejected Pacific's request in a Proposed Decision issued April 8, 1996.

calculation and asks the Commission to establish a separate explicit funding mechanism to permit recovery of the depreciation reserve over a defined period of time (SWBT, p. 23-24.) SWBT claims it is entitled to this because the depreciation reserve results from investments made under a "regulatory compact" and the advent of competition means that SWBT will be unable to recover this investment.

AT&T and other Regional Bell Operating Companies (RBOCs) have all taken opportunities in recent years to engage in large writeoffs of investment due to increased competition. The SWBT write-off represents nothing more than an accounting change. No plant will be retired. No assets will be lost. No CEO will lose a bonus. Stockholders will continue to receive the same dividends. Coincident with the elimination of rate of return regulation, the shifting of existing rate base to depreciation reserve will not impact the revenues of the company. In sum, the accounting change means that SWBT will benefit from lower taxes and improved cash flow, and be in a better position to profit from future operations. SWBT will not suffer from this accounting change.

The Commission should reject SWBT's argument for several other reasons. First, as SWBT admits, its $4.7 billion "write-up" is due to accounting changes precipitated by increased competition. LECs have no persuasive public policy claim and no legal right to be protected from or compensated for financial difficulties owing to competition. Cases regarding unconstitutional takings hold that the potential adverse effects of competition are not relevant to a takings analysis. "The due process clause . . . has not and cannot be applied to insure values or to restore values that have been lost by the operation of economic forces." Market Street Railway Co. v. Railroad Commission, 324 U.S. 548, 567 (1945). In Public Service Commission of Montana v. Great Northern Utilities Co. 289 U.S. 130, 135 (1933), the U. S. Supreme Court explained the same rule this way:

> The due process clause of the Fourteenth Amendment . . . does not assure to public utilities the right under all circumstances to have a return upon the value of the property so used. The loss of, or the failure to obtain, patronage due to competition does not justify the imposition of charges that are exorbitant and unjust to the public. The clause of the Constitution here invoked does not protect public utilities against such business hazards.

Furthermore, the factual basis for SWBT's claim is sorely lacking. Competition has not rendered SWBT's network obsolete; far from it. SWBT enters the era of local competition with 100% of the market for residential and small business service. SWBT controls the local facilities in its service territory to which competitors must connect in order to enter the local exchange business. All resellers operating in SWBT territory will pay SWBT for use of its local exchange facilities. When competition exists for local exchange service, SWBT will have the opportunity to compete in other markets. SWBT, like every other incumbent LEC, will have ample opportunity to earn a fair return on its investment, based on its ability to compete successfully. Finally, the Commission should not assume that SWBT's depreciation reserve was accumulated for the sole purpose of meeting universal service obligations under cost-plus regulation. SWBT, like every other large LEC, invested in plant for the express purpose of providing advanced services such as ISDN and future broadband services. These and other investments were made by SWBT and other LECs to position themselves for competition. Basic service ratepayers should not be held accountable for SWBT's depreciation reserve.

IV. THE COMMISSION SHOULD REJECT PROPOSALS TO ESTABLISH AFFORDABILITY THRESHOLDS

Requirements to adopt affordability "thresholds" should be rejected. For instance, in its opening comments and through attached comments prepared by NERA, BellSouth advocates that the Commission establish an affordability "benchmark" of $17.06 per month. NERA asserts that increases to local rates and to the EUCL will not make telephone service less affordable because there should be offsetting rate decreases to other services. Further, BellSouth, through NERA, argues that following the introduction of the subscriber line charge, subscribership increased. (BellSouth attachment, p. 26-27, 33, 17-18)

These proposals and arguments should be rejected. First, proposals to establish affordability thresholds exceed the scope of this proceeding. The goal of this rulemaking is to establish interstate mechanisms for achieving the universal service objectives put forth in the Act. For all intents

and purposes, advocates of "affordability thresholds" are asking the Commission to set rate bands for basic service and, effectively, sanction basic service rate increases. Establishing basic service rates and permitted rate levels is the responsibility of the states. Generally, as a matter of law, state commissions do not permit basic rate increases absent a thorough consideration of evidence as to whether such increases are just, reasonable and in the public interest. The Commission has no legal authority to set intrastate basic service rates. Further, the Commission lacks the evidentiary record to determine just and reasonable rates for customers in every state.

Second, proposals to establish affordability thresholds are disingenuous and the Commission and Joint Board should not accept their proponents' claims at face value. For example, BellSouth, through NERA, admits that one factor that helped alleviate the impact of rate increases and the imposition of the EUCL on telephone penetration was the decision by state and federal regulators to establish lifeline assistance programs. NERA notes that from 1987 through 1994, federal funding for lifeline service increased from $12 million to $123 million. (BellSouth attachment, p. 22) Few, if any, such programs existed at the state level prior to divestiture. It is certainly possible that lifeline programs helped subscribers continue to receive service. But it is not reasonable to conclude that, absent the introduction of lifeline assistance, rate increases would not cause reductions to subscribership. The rosy picture painted by NERA masks the fact that there are large disparities in subscribership. A recent FCC report on telephone subscribership shows that telephone penetration varies greatly by ethnicity. In 1994, on average, 93.8% of total households had a telephone. The percentages of household units with telephones, by ethnicity were: white, 95.1%; black, 85.7% and hispanic, 86.0%.[8] Further, as noted in NASUCA's opening comments, telephone subscribership declined from 1993 through 1994. (NASUCA Opening Comments, p. 2.)

Accordingly, if the Commission and Joint Board entertain affordability standards, they should undertake a detailed analysis of claims that raising rates will not harm penetration levels, let alone

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[8] "Telephone Subscribership in the United States," Federal Communications Commission, Industry Analysis Division, Common Carrier Bureau, August, 1995, p. 27

make service "more affordable." The Commission should closely examine its own statistical database regarding subscribership, along with information about general economic conditions in each region of the country. FCC subscribership data shows that when rates remain constant, subscribership falls in accordance with income. The Commission should consider the potential for further declines in subscribership if rates increase while income remains constant

There is no conclusive evidence to suggest that increases in basic service rates (or to the EUCL) that are tied to reductions in message toll services or access charges are fair, non-discriminatory, or even real. To the contrary, there is a real concern that recent access charge reductions made possible by LEC over-earnings have not benefited all customers. If this concern is verified, the LEC proposals would clearly be detrimental to Universal Service.

SWBT suggests that the Commission establish a benchmark for affordable rates that is equal to 1% of median income. But this proposal is nothing more than an elegantly packaged request for Commission-condoned rate increases. In attachment 4 to its comments, SWBT provides a table illustrating affordability benchmarks for states located in its service territory: Arkansas, Kansas, Missouri, Oklahoma and Texas. The rate changes that would occur in Arkansas and Texas are instructive. SWBT provides an illustrative "affordability Benchmark" of $19.20 for Arkansas, including a $6.00 "interstate benchmark." $19.20 represents 1% of the median household income for 1993, according to SWBT. In Arkansas, SWBT has four rate groups and customers in smaller exchanges pay lower rates. Residential basic service rates range from $12.11 for Rate Group 1 (1-3000 lines) to $16.31 for Rate Group 4 (72,001 and more lines).[9] Under SWBT's proposal, customers in rural areas, who have the least chance of seeing competitive choice in the foreseeable future, would have the largest rate increase -- from a current rate of $15.61 (including the EUCL) to $19.20, an increase of $3.59 or almost 23%. In contrast, customers in rate group 4, who currently pay a total monthly charge of $19.81, would have a rate decrease of $ 60. Out of a total of 560,662 lines, 423,975 would experience rate increases. Customers in Texas would fare

[9] Source: "Bell Operating Companies Exchange Service Telephone Rates," National Association of Regulatory Utility Commissioners, December 31, 1994, p. 27-28.